



The Jerome Levy Economics Institute

Public Policy Forum

Poverty and Prosperity in America at the Close of the Twentieth Century

June 20, 1991

PARTICIPANTS

Robert B. Avery
Sheldon Danziger
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The Jerome Levy Economics Institute of Bard College,
founded in 1986, is an autonomous, independently endowed research
organization. It is nonpartisan, open to the examination of diverse
points of view, and dedicated to public service.

The Institute believes in the potential for the study of economics to
improve the human condition. Its purpose is to generate viable,
effective public policy responses to important economic problems. It is
concerned with issues that profoundly affect the quality of life in the
United States, other highly industrialized nations, and countries with
developing economies.

The present research agenda includes such issues as financial
instability, poverty, unemployment and problems associated with the
distribution of income and wealth. Other research interests include the
issues of public and private investment and their relationship to
productivity, competitiveness, and the prospects for growth and
employment. In all its endeavors, the Institute places heavy emphasis
on the values of personal freedom and justice.

PREFACE

From June 18-20, 1991, more than eighty experts met at the Jerome Levy Economics Institute to address issues involving the distribution of wealth and income in the United States. The conference climaxed a year-long Institute research project on "Poverty and Prosperity at the Close of the Twentieth Century."

As is characteristic of the Levy Institute conferences, the three-day gathering concluded with a roundtable discussion of the major public policy issues raised during earlier, more formal presentations. This Public Policy Forum on "The Prospects for Future Policy," transcribed here, included the following distinguished participants:

Robert B. Avery, Cornell University

Sheldon Danziger, University of Michigan

William T. Dickens, University of California-Berkeley

Robert Haveman, University of Wisconsin-Madison

Dimitri B. Papadimitriou, The Jerome Levy Economics Institute of Bard College (Moderator)

Timothy M. Smeeding, Syracuse University

Edward N. Wolff, New York University

Copies of papers delivered are available upon request.

THE JEROME LEVY ECONOMICS INSTITUTE OF BARD COLLEGE

Public Policy Forum on

The Prospects for Future Policy

at the conclusion of the Institute's conference on

Poverty and Prosperity in America at the Close of the Twentieth Century

Dimitri B. Papadimitriou, *The Jerome Levy Economics Institute (Moderator)*

Robert B. Avery, *Cornell University*

Sheldon Danziger, *University of Michigan*

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The goal of the Jerome Levy Economics Institute of Bard College is to improve public policy by studying problems, finding solutions, and communicating recommendations to those who can influence government action. This particular conference is the culmination of a project we have undertaken on "Inequality and Distribution of Wealth and Income in America at the Close of the Twentieth Century." Our goal was for each study of an issue or topic to result in practical recommendations for improving current tax, transfer, and other policies that affect the division of the economic pie.

Most of the papers presented over the two days of the conference provide policy-oriented conclusions in addition to identifying policy problems. Some of these were debated yesterday and today by the formal commentators and others. The purpose of this session is to concentrate on the policy recommendations drawn from your research. In so doing, we need to distinguish public policy problems from research problems. We need to be concerned with the cost of the policy problems, i.e., the cost of doing nothing being demonstrably serious enough to warrant government action. In addition, given the federal budget difficulties, recommendations to use resources more efficiently and fairly obviously have far more political potential than do those requiring new resources. Finally the values and principles reflected in the solutions must be politically acceptable to voters. In the discussion to follow, each of my fellow panel members should focus on poverty and distributional problems, policy issues and possible government responses.

ROBERT AVERY:

I would like to talk about three areas. First, how we as economists are functioning in our role as scientists and what we can contribute. Then I will discuss two public policy areas, household structural change and wealth. The latter is the area I spend a lot of my time thinking about.

I spent eight years at the Federal Reserve; in terms of how close an economist can come to actually making policy, the Fed is one of the best places to be. As far as what my role might be, my view when I left was quite different than that which I had when I started. I now fundamentally believe that our role as research scientists is to provide information from which policy makers, who are drawn from the public at large, can make decisions. Though we do have the privilege of providing information directly to the policy maker, we have no more right to advocate a particular policy position than anybody else.

In this regard, what we are doing as a profession is sadly deficient. Deregulation of the banking system, for example, was obvious to most people who thought about it, yet we failed to provide information to help make better decisions.

One reason has been the significant depletion of the Federal statistical agencies over the last 15 years. If I look at the quality of staff at the Federal Reserve Board in the early '70s, it was very different from when I left or when I was there. And it is much more pronounced in agencies like HHS and the Department of Labor. Everywhere, it seems there is an eroding ability to think about policy even a year or two years off, much less do any kind of in-house analysis. Indeed, most of the surveys we have talked about at this conference are surveys that have been in place for the last 15 years.

A lot of this can also be traced to the declining value our society places on public service. In any event, we are going to pay a significant long-run cost.

Let me shift gears and talk a little about policy. One of the things that I have increasingly become aware of is that we have not thought enough about the issue of structural change at the household level. For example, we have paid too little attention to the long-run consequences of divorce and the changing nature of the extended family. In terms of long-term health care, we need to be asking questions about the relationship between divorced parents, children, and the effects on intergenerational relationships. It is not clear that we can extrapolate from the previous generation here, since people who got divorced in the 1950s were not as likely to have anticipated it or developed their human capital as insurance. This is an area in which there is enormous need for study and where there may be implications for institutional change.

The same goes for questions involving family leave policy and child care, part-time and flexible-time jobs, as well as productivity. We have developed stereotypical views of household structure — with one wage earner — even though this structure has changed. Our profession hasn't provided information and guidance to industry on how to accommodate family structures which might have very different needs than those of 30 years ago.

I also look at the role of young adults. For each quarter, somebody is moving in and out of 15 percent of households — an unbelievably high number. How do we treat young adults who instantly move in with their parents when they become unemployed? Who is responsible? Does society have a role in supporting these young adults? We have steered away from these kinds of problems because they do not involve well-defined concepts.

The last area I would like to touch upon pertains to the role of wealth. Income is much more highly related to short-run well-being and, perhaps as it should be, has been a more greatly weighed factor in determining policy. Still, because we have not collected wealth data, we have tended to shy away from policy questions that are highly related to wealth. There are areas of taxation in particular where it is extremely relevant.

The best example I can think of is society's decision to have a high real rate of interest in response to budgetary deficit. This has had major distributional impacts which have not been explored at all. Paul Volcker may be brilliant, but it was really his unilateral decision in 1979 and we didn't have the data. We had chosen not to focus on wealth as opposed to focusing on income, while Volker's move had a major distributional impact.

SHELDON DANZIGER:

In 1971, Robert Haveman wrote a book in which he said, given the programs and policies in place, and given the expected growth in the economy, there should be no officially measured poverty by 1980. Obviously, contrary to that publication, we are now in a situation where we have more poverty than in 1970, and where we are about to get more with data for 1990 and 1991 on the effects of the current recession.

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So in most of the papers presented in this conference, you have peak or close-to-peak data, and the focus has been on why things aren't getting better even though the economy has been growing. In some ways, what we have now is a nice social experiment, because the economic recovery, combined with the Reagan policy of cutting back on income transfer programs in particular, has essentially generated a really universal consensus on the ability of the economy to alleviate poverty on its own. This new consensus has developed on the directions in which to move, even though disagreements may exist about the particulars of a policy. Some people would point to the welfare reform that Senator Moynihan negotiated, the Family Support Act, as evidence.

Historically, one of the initial motivations for the war on poverty was the realization in the '60s that, even as the economy grew rapidly, there was a large group of poor people out there who were seemingly being left behind. Similarly, we need an active anti-poverty policy now because there are people being left behind in a healthy economy. If you read between the lines of a speech he gave last week, President Bush sort of said that there are some things government can do. The big success of the Reagan era was in giving all the money to other areas so that now, despite a broad consensus, there is no money to deal with poverty and education.

Normally you assume that in a recovery everybody is moving up the escalator. In this recovery, while one group started to move up, it was as if somebody turned around and gave a push and the people toward the bottom got knocked down a number of steps. The Reagan changes in universal insurance, AFDC, tax policies, etc., pushed them even a little further down the steps. As Alan Blinder said earlier today, in almost all areas the groups who were already disadvantaged fell back. The one exception is that women's wages rose relative to men's.

For most being pushed back, it was the result of changes in labor market policies. Even if government policies of the 1970s had been in place, the poor and low-educated workers would still have fallen. It is not that people are staying unemployed because UI and AFDC are increasingly generous; rather that they are increasingly poor, in many cases, even though they are working as much. For example, take black non-Hispanic males of the prime working ages of 25 to 54 who were putting in 50 to 52 weeks of work in north central cities. No one would define them as the underclass. In 1979, 8 percent of them earned less than \$12,000 a year; by 1989, the number had doubled to 16 percent. This is a group whose labor supply is constant; their income is not a supply issue.

In addition, consistent with the Blackburn paper presented earlier, a high-school diploma is no longer enough. Indeed, there is an increase in low earnings among both black and white college graduates of the prime working age.

There is a notion that something is going on in the labor markets. We as economists see the symptoms but don't really understand the causes. We write a lot of papers assuming that it is a demand phenomenon, and that the causes are unionization, the changing industrial structure, and global competition. We cannot simply go back to the late 1970s since we would still be in a worsened distributional position with those policies in place. Yet, to cure the problem, instead of treating the symptoms, we need a set of policies in areas where I think there is enormous consensus.

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An example consistent with what Bob Avery just said and what Larry Lindsey mentions in his book is to expand the subsidy for child care. In particular, the dependent care tax credit should become refundable. Unlike higher-income families, many of the working poor and near poor can't get subsidies. The Tax Reform Act of 1986 has taken them out of income taxation, but leaves them without refundable credit because they cannot use exempted dependent care expenses to offset taxes.

The law should be changed to make it refundable. This is very attractive to economists, far superior to setting up a national day care system. Phil Robins, for one, would propose changing the current law where the credit is 30 percent and nonrefundable to 80 percent refundable for the poor and the near poor.

In another area, the National Commission on Children is going to propose turning the personal exemption for children into a refundable tax credit. Again, there is actually enormous consensus. The far right would like to raise the child care exemption very high because they want women to stay at home and have more kids, while to the left this would subsidize both working and nonworking mothers. It would be enormously important for low-income families.

I wrote a paper back in 1979 with Bob Haveman in which, as the Sterling paper suggests, we actually proposed turning the exemption into a \$600 refundable tax credit. Our figure would be the equivalent of \$2,000 today. So, contrary to what Bob Avery just said, it has not been for lack of knowing what to do.

The big question is, of course, where do we get the money to do it. With the Downey-Gore proposed bill Tim Smeeding mentioned, we could easily get the money to make the child care tax credit refundable by merely raising the top bracket tax rate from 34 to 37 percent. However, the consensus I have talked about breaks down when we mention tax rate changes.

There are other areas we can think about changing. The earned income tax credit area is another example which functions like a wage subsidy. The whole health area, particularly child health, is an important one that relates to Barbara Wolfe's paper. Finally, if you believe that there is a serious labor demand problem — which reminds me of my study of black males of prime working ages in north central cities — I think you have to turn to some sort of a guaranteed employment policy. There is not anywhere near as much consensus on these sort of proposals because of the difficulties in implementing them. Nevertheless, though we don't know how to prevent the economy from generating low wages even for full year workers, we certainly do know how to subsidize people in a way that would not produce adverse consequences.

WILLIAM DICKENS:

Yesterday, in my commentary on Tim Smeeding's paper, I said that I was going to talk about making the punishment fit the crime in terms of changes in the income distribution and public policy prescriptions for it. Actually I will be reiterating and filling in to some extent on what others here have already written and said.

I find certainly a lot of interesting things going on with the distribution of income and the changes in household income due to family composition. The important thing that grabs my attention has been the very large changes in

the earnings distribution and the fact that, in particular, the relatively less well-off, in terms of earnings, have gotten worse off in the 1980s. This is not just high-school dropouts, but also high-school graduates who have had the particularly bad fortune of entering the job market in the 1980s.

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About half of the change in the 1980s can be attributed to the increasing returns of two factors: college education and experience. This has also been shown in a paper by Katz and Murphy and is basically reconfirmed by a rough estimate by Blackburn and Bloom in their findings. The increase in the return to experience is concentrated among the less well-educated. But, is it really an increase in return to experience? We don't know, because we are looking at cross sections. What it might be instead is a decrease in the return to education primarily concentrated on factors of labor market entry because there might be an oversupply of people relative to the labor market demand in the 1980s. These studies show that with just a constant trend increase in the demand for skilled labor, one can explain most of the observable increase fluctuations in return to education over the '70s and the '80s. If one also adds that there may have been a substantial increase in the 1980s, then you can tell a very consistent story about increasing returns to education having to do with increasing demand for more highly skilled workers. The total effect of this increasing return to skills is probably greater than the reported 50 percent because the Population Surveys only measure a very, very small part of the total skill acquisition.

What are the policy implications? Let me talk, first of all, about the question of whether we should tax the rich. We probably should, but this may not be the right reason. If it were the case that what we were seeing was an increase in the return to a native ability that was just being signaled by the acquisition of higher education, that would be a different story. However, if the difference is due to a change in an acquired trait, then one would think that one of two things is true. It is either transitory because this big return to education is due to everybody deciding to go to school. As I show, during the 1970s and '60s there was this pattern of the return to different types of education going up because people entered particular fields. So, either it is going to be transitory—so in the '90s, everybody would be going to college and this phenomenon will be seen—or it is not going to be transitory. Blackburn, Bloom, and Freeman have shown in their data and estimates that there have been changes in the supply side, making it not transitory.

The fact is that costs of education have been going up during the 1980s. This is not because of avarice or greed, but rather the pure and simple economics of a very labor-intensive industry. The cost of educated labor, the primary input, has been going up.

What has also increased the costs of getting a college education is the big drop-off in the amount of student aid or loans that is available. There is much more money being given out on the basis of ability and much less for need.

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Alan Blinder talked about the fact that a lot of people going to school are capital constrained. It is not easy for them to borrow to cover all of the costs of education. Even if they can borrow the money to pay expenses, they can't borrow the money to make up for the opportunity costs of going out and getting a job. If you are from a poor family where the previous generation didn't have a college education, you are double whammied because the costs are going up but income or family earnings are going down. So there is a greater probability that this inequity is going to be perpetuated intergenerationally.

What sort of conclusions do we draw from that? Here we get into the discussion that we had this morning. Do we want to subsidize education as a way of solving these problems? First of all, let me point out that we don't want to tax the higher income resulting from a college education since all we are going to do is increase the distortion and the number of people who aren't going to school. That is not the way to solve the problem.

Considering the fact that at Berkeley, in a good year, about half the undergraduates in my labor economics class have already had introductory economics. This is probably the upper half in terms of their ability to understand these sorts of issues. I question whether the rest of them made net present value calculations and the like before they arrived on the spot.

So what do I think determines one's level of education? Probably a lot of sociological factors. Cost factors certainly matter. We know it is going to push the distribution around, but I doubt it is determining the mean of the distribution. I think we should do some cost benefit analyses other than the ones already done, which look only at incomes and conclude that whether a college education is worth it depends on your discount rate. Interestingly, there is a study by Bob Lucas at Boston University, back in about 1978, in which he did add into the cost or the value of higher education all of the nonpecuniary benefits that one gets.

We know, for instance, that pensions go up when your money income increases and there are a lot of other things like that. Your job gets savory and more pleasant. All of these are things which are essentially consumption goods that add positively to income. So, we are tremendously undermeasuring the return to a college education when we only look at money income. In any case, it seems to me that a cost benefit analysis will suggest that the increase in the expenditures on higher education might not be a bad thing to do, and that might not be a bad way of addressing the problem of the sort of inequality that we see.

People do talk, however, about the fact that subsidizing higher education would have adverse effects on the income distribution, in the sense that it would promote an increase in the disparity of income so as to move those who are educated out of the middle class and into the upper class. The charge is also made that when you subsidize higher education, for the most part you are subsidizing people who are already relatively well-off.

Let me point out another consequence. When you decrease the supply of high-school-educated labor, you increase its return relative to what it would otherwise be. In this sense you bring the bottom up. So I am not convinced that the distributional consequences are fully thought out and would be so terrible, even if the aid is not particularly well directed. If it is well directed, I have a lot of sympathy for the idea of pushing it more into the areas of technical training. There it might be better utilized for intergenerational mobility.

Finally, let me talk briefly about the relationship of income distribution disparity and nonmarket factors affecting labor. In my work I am a great promoter of the notion that we should take nonmarket clearing views of the labor markets seriously. In particular, my view is that an awful lot of what determines blue-collar wages is unions, even when unions are not present. All sorts of evidence show this point.

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Just anecdotally, if you ask compensation specialists in large nonunion firms what they think they are doing when they set their wages, they say they are looking at the wages of union plants and that their primary concern is that they don't want to see any union coming in. This goes about it the wrong way; one could tell another story with the same facts. Instead, during the 1980s we bashed unions. We not only lowered the wages of people who stayed in them or left them, but also those of workers who were never in unions but could previously use the threat of unionization. Actually, I expect the latter workers' wages to fall even more than the union workers'. It is rather clouded, however, during the 1980s.

This theory might explain why blue-collar wages, essentially those of high-school graduates and the less educated, have fallen relative to nonunion white-collar workers' wages. It also works for a number of other countries that have experienced recent union bashing, such as Great Britain and Argentina. Countries that have had relatively strong and stable union movements, like Germany and Japan, seem not to have experienced the same change in income or earnings distribution.

Why then am I not up here saying we should promote unions as a potential counter to the problem of income and earnings distribution? Because I have been convinced that there is enough other evidence against it to make it unconvincing, even though I would like it to be the right explanation. First of all, as the discussion this morning touched upon but didn't quite get right to the point, the decline in unionization started in 1953, which was the peak year. Though the rate of decline accelerated in the 1970s and accelerated even more in the 1980s, one would still expect to see some of this effect before the 1980s. And yet you don't see it. So the timing is wrong.

The other thing that I find convincing is that when you run a regression for distribution testing, the relative effects of education and changes in occupation and industry, education wins hands down. I would think that if it were unions that mattered, education wouldn't win the horse race.

Though occupation is, it should be noted, not particularly well measured, I rather strongly lean towards the belief that the culprit is increasing returns to skills and particularly acquired skills. Thus, if I were looking for a policy prescription I would be looking more at addressing the increasing costs of education.

ROBERT HAVEMAN:

The purpose of my comments is really to make some summary statements with respect to the findings of the research papers we have had today, and then to suggest a menu of policies that I think are targeted on the groups that we have identified as being the most in need.

First the general thrusts. We heard a number of papers at the conference that have spoken about the increasing earnings inequality among males over time, along with stagnation in the increase of mean earnings. The source of the growing inequality in male earnings was in dispute — as to whether or not it rested with the wage rate or labor

force participation and work hours inequality was in dispute — with Becky Blank having one position and Blackburn, Bloom, and Freeman quite a different one. Nevertheless, the phenomenon as it affected males was not in question.

We heard from Sheldon Danziger and his coauthors about the falling earnings inequality among women coinciding with increasing earnings inequality for men and families. As was revealed in a number of papers, the overall result was increased income inequality for families, even though wives were contributing more than before. From these papers and the discussion, one gathers that this has led to a long-term slowdown in the reduction of poverty as we officially measure it.

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Within this poverty population, we learned from a number of papers that the composition of the poor has also changed. The winners who have tended to move out have tended to be older people and have tended to be intact families, including black families. Those who have moved in have tended to be mother-only families, minority singles, young people, and those with extremely low educations. When an alternative view of poverty is used, one which focuses on those who are poor in capabilities and in their long-term productive characteristics, the changes in this bottom tail of the distribution is even more severe. This is to say that increasingly the hard core of the nation's population of economically dependent people is minority, single male, and single mom. It increasingly has a low level of education, indeed a very low level. It is increasingly populated by children. As a result, one could conclude that this hard core of the nation's population is the first which is not able to work itself out of poverty or use the labor market effectively.

It is dominated by a set of groups that I now want to identify and use as the basis for a discussion of a targeted set of policies: 1) Working-age single moms who are largely black; 2) working-age single youths who are black and Hispanic; 3) heads of household and children, who are mostly black, with less than nine years of education. Believing that people with these characteristics have filtered to the bottom of the capability distribution, I think certain notions about targeted policies become clear:

First, a policy ought to be redirected on the margin so as to target the working-age population with low skills. In other words, I am talking about labor market reform. This is quite consistent with David Levy's point at the beginning of the conference that public policy concerns for this population have to be designed to decrease the nonemployment of the people at the bottom of the income and capability distributions.

If one is talking about reform of a market, one is talking about changes on its supply and demand sides. I suggest a two-prong policy which has been modestly studied and, indeed, more modestly tried.

On the demand side, there is substantial potential in thinking through an employer-based marginal employment subsidy. We had one a dozen years ago that was modest in size and short-lived. It was called the New Jobs Tax Credit, and a number of research studies indicated it was a potential instrument for employing low-skilled workers. The idea here is employer-based employment subsidies targeted on lower-skilled workers. This would make it more attractive for employers to hire disadvantaged workers, shifting the demand curve for the disadvantaged to the right.

A second prong would operate on the supply side. I suggest a wage rate subsidy in which the subsidy rate is larger for those workers who can only be employed at very low if not minimum rates, with the subsidy decreasing as a worker's wage rate rises. Such a subsidy would increase the take-home wages of workers relative to the market wages that they are paid. As a result, it would become more attractive for disadvantaged workers to supply their labor to the labor market. In effect, this would shift the supply curve of low-skilled labor to the right.

Now there is a lot to be studied about these two policies: displacement effects, the degree of response by both employers and employees, and the impacts on the overall market wage. Nonetheless, let me suggest that it has potential and is worthy of consideration.

Other policies I propose would be targeted on families with children. Let me mention several that deserve further thought:

■ Child care subsidization for single parents conditional upon their working or taking training. It would be meant for people who would supply the labor market were they able to provide adequate child care for their dependent children. It is, again, designed to shift the supply curve of disadvantaged workers to the right.

■ Universal child support. This was talked about a lot a few years ago but was not discussed much here. It would substitute support from the absent parent for public welfare support. A former colleague of Sheldon's and myself, Irwin Garfinkle, has done a lot of work on the design of such a measure, which is certainly targeted in the right direction.

■ Some policies targeted directly on youth. Edward Wolff, in his paper, talked about the desirability of shifting the wealth distribution in favor of young workers. He is really talking about a capital account for them. There have been other people who have written about this in recent years, particularly Michael Sheridan, a social worker whose book has just come out. His work draws attention to the leveraging effect on behavior and aspirations of providing assets and stakes in assets to low-wage poor people.

■ Policies targeted on schoolwork, vocational training, and the quality of education at the K through 12 level. I will only mention this as I don't feel at all qualified to speak about it, but in my view it is a potentially fruitful area for policy.

■ Policies targeted directly on minorities. Here, it is hard to think of very much beyond effective enforcement — or perhaps strengthening — of affirmative action.

■ Finally, policies targeted on individuals with multiple problems. In this respect, the Hill/Barbara Wolfe paper today had the effect of making me at least think through the incredible disadvantages of people who have several of these problems afflicting them simultaneously. Here is a population that comes close to being the underclass population that so many people talk about.

This then would be my catalog of potentially fruitful redirections in policy that I think were guided and enlightened by the research papers at this conference.

TIMOTHY SMEEDING:

As I have sat here yesterday and today I heard no one disagree about whether we had greater inequality in the 1980s, whether it is wages, earnings, income, or wealth. Now is this bad or good?

The bad part, as Sheldon Danziger and others hit on, is that the disadvantaged groups aren't doing as well as they did earlier. Upward mobility from below and from the very bottom is low. It probably won't get any better.

Unlike Bill Dickens, I am not unhappy that a lot of people are moving up and out of the middle class. I think that is great. But to find the money to finance all of the things we have been talking about here, we have to look at increasing federal revenues.

As it was shown, wealth hasn't increased in inequality over the '80s that much. On the other hand, we did see that there was only a gain of \$3,000, maybe \$6,000, at the bottom as opposed to somewhere around \$100,000 at the top. I ask you, whose kids are going to have greater access to college? Whose grandparents are going to be able to help their kids get into the housing market when they need it? Which particular racial and minority groups have characteristically not had much wealth? This is why Bob Haveman is recommending the policies he just outlined.

Inequality increased in all countries in the '80s, but from my comparative work it is very clear that the United States' public policies were less responsive than in any other country. Other systems do a much better job of leveling than ours.

In addition we ran up a big debt and a continuing deficit. Generationally I think this is going to have an important effect. Let us not forget that during the decade taxes became less progressive. With increased pressures at the state level, revenue needs have increasingly been met by less progressive instruments such as sales, gas and property taxes.

What is going to happen in the 1990s? As Sheldon Danziger pointed out and Becky Blank showed in her paper, the economic recovery of the 1980s didn't exactly have the same distributional impact as growth in the 1960s did. In fact, quite the opposite. I can't help but think that this current recession can only exacerbate the problems we have seen. Furthermore, as David Bloom's work showed, there is the problem of falling salaries and school enrollments, with fewer kids coming through the ages of 18 to 24 prepared for jobs. The labor market will be tightening up.

Only the best and the brightest will be hired. Presumably if the demand for labor continues, in ten years there will be fewer people looking for a job. But what will happen if Ford Motor and other companies say, our biggest markets

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are in Europe or Korea or Spain, and that is where we are going to manufacture our cars? Further, the free trade agreement can only make you and me better off because we'll be able to buy cheaper products; yet most routine jobs will move to low-wage areas and fall across the border. Together with the lack of a clear federal domestic agenda and an education policy which existed previously, we will have a problem. I am not too hopeful.

**Income tax can
be a little more
progressive....
We could expand
the taxes to
fringe benefits
and transfer
payments
including social
security.**

Let me underscore that children are in trouble and need some help. The consensus Sheldon mentioned is certainly there. I don't know if I would go all the way to Bob Haveman's almost Swedish active labor policy, but you never know. Next year, Dimitri, you may end up with a consensus right there.

But the point is, where are we going to find the resources to finance these programs? This is where the paper Greg Duncan and I did fits in. As we have shown, there is a group of people who can now afford to help other people. It is not just us planners on the left; Kevin Phillips wrote about it, too.

Income tax can be a little more progressive. I am not talking about going back to 70 percent marginal tax rates or even 50 percent or 40 percent, but going from 34 to 37 is not that bad. We could expand the taxes to fringe benefits and transfer payments including social security. Because of the exemptions and other built-in features of the Federal Tax System, this wouldn't be paid by people receiving AFDC and most people receiving other means tested benefits. It certainly would mean that the elderly would pay a larger share of their income in tax, but I think those living on \$30,000 a year could afford to.

Again, it would not be a confiscatory taxation, but would be targeted on capital gains and transfer. I am talking about a tax rate of 10 to 15 percent. In fact, if you believe people are dumping assets to qualify for nursing homes and Medicare, it may even have some positive behavioral effects. I am willing to accept an Alan Blinder-like adjustment for price increase from the time of the purchase and sale of asset, in other words making it a real tax. We have to find the revenues somewhere, and this seems to be the least costly way of doing it with as little burden as possible.

EDWARD WOLFF:

The proposal I would make is what Bob Haveman and Barbara Wolfe have advocated, something that I have called a social security capital fund. This approach has a number of virtues and may also redress some of the intergenerational imbalances that have been occurring over the last several decades.

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As brief background, I mentioned earlier today that, since the early 1960s, middle-aged groups have become wealthier while younger age groups, those under 35 particularly, have become less well-off in terms of wealth. We know from the work of Frank Levy and others that the same thing has been happening with income. Part of the reason is that the younger generation, the baby-boom generation in particular, has experienced a very sluggish labor market and depressed wages. Part of the reason is apparently also that the savings rates of the younger age groups have fallen tremendously over the last generation. Meanwhile, I have been struck by how the older generation has accumulated so much wealth that there is no feasible way that it can run down its assets before death. Almost by default, the children of the current elderly will be inheriting quite substantial sums.

Perhaps this is one reason why the younger generation has not saved very much, but whatever the reason I think there is some rationale for trying to transfer some wealth back to the younger generation, and one mechanism is through this social security capital fund. Such a plan is currently in effect in Singapore. It would not be tied directly into the social security system because there is very strong collateral — social security contributions are pretty sound investments. Even if it doesn't go into an actual fund, the expectation of benefits provides a fairly strong guarantee that a loan taken out will be repaid.

Perhaps the banking system might be involved or the federal government could handle some kind of banking operation, as it does now implicitly with the various housing loans it guarantees. In any case, the Federal Government has had a history of setting up loan programs for specific purposes and this part of the proposal is by no means revolutionary. The only new provision is to treat the OASI contributions as collateral.

As to funding, let me say that part of the reason why I undertook the paper I gave this morning was to see if taxing social security transfers would provide sufficient loanable funds to establish this kind of program and have a reasonable effect on the wealth of the young. The answer turns out to be no. It produces a fairly low level of additional tax revenues. The additional tax revenue raised as a proportion of the current wealth of families 30 and under would amount to only 2 percent of the current wealth; for families 35 and under it would amount to only .7 percent.

So there would be some problems in finding funding. On the other hand, a solution could be to cut defense expenditures. Compared to other OECD countries, the U.S. spends a much higher percentage of its budget on defense spending. Even if there weren't a peace dividend as a source of funding, the fund could operate like any other kind of loan fund with a reasonable interest rate attached to it.

Such a fund could also provide a supplement to unemployment insurance. As we all know, both the unemployment coverage and the unemployment insurance benefit levels have declined rather drastically during the 1980s.

In any case, this kind of plan has a lot of virtues and it does help to alleviate the kind of imbalance that is occurring now between the generations. This is one kind of a program which, although not entirely new, has a lot of possibilities and deserves to be explored further.

DISCUSSION

ROBERT AVERY: At the risk of being placed over the other side of Sheldon Danziger, let me be the devil's advocate for a moment. If we were to go back ten years and somebody were to sit here and tell us that Ronald Reagan was going to be elected president, that we were going to have 21 percent rates of interest, that we were going to have the worst recession since the depression, that we were going to have the highest real rates of interest during this decade of the past century, or that we were going to have a major cut in, or essentially eliminate, the corporate income tax and cut the personal income tax rate, cut rates to the extent to which we have, cut programs to the extent that we believe we have, run up our national debt by 250 percent over that period of time, most of us would have said that this will be a disaster and that we were going back a hundred years.

Now, if we look at the truth of the matter, if we look at the changes in both the wealth and income distribution, we would see that the effects are remarkably small. I can't see any change in the wealth distribution over this period of time, and as for the income distribution, the changes have been relatively minor.

One question to ask is, maybe society and individuals are a lot more resilient than we think they are. They adjust. They change. If they realize they need more education, they go and get it. When they realize they should change their job, they go and they acquire new skills. Maybe we ought to think twice about our proposals for change. Maybe the fundamental forces that move society can't be changed by the kinds of policies we are talking about.

SHELDON DANZIGER: Let me trade places. I think the changes in inequality are historic. Alan Blinder wrote a marvelous paper starting with the famous idiom that said, "I don't care about inequality being stable," and it was mostly stable from, 50 to '80. Some of the consequences that Bob and Ed have talked about, we won't see until the next generation of kids isn't moving forward. I am not an economic historian, but if you look at Williamson's *300 Years of American Inequality*, this decade is unlike any others, I think, except the '20s, in that regard, and there are probably others as well.

If you go about saying what would it cost in public policy to go back to where we are in 1980 inequality, you are talking about a modest set of proposals like expanding Head Start and WIC, without getting into some of the more forward-looking things that Ed Wolff and Bob Haveman were talking about. Even George Bush is for expanding Head Start to everybody. This modest package would cost fifty billion dollars a year.

**DIMITRI
PAPADIMITRIOU:**

Speaking about costs and benefits, are there any policies that should be abandoned because they are bad policies and don't deliver the goods?

SHELDON DANZIGER: I don't think you heard anybody here say raise welfare benefits for the able-bodied, and that is the difference between now and 20 years ago. When I first started in this profession, people like Bob Haveman were saying we ought to have a negative income tax and you don't hear that from anyone. We have learned a lot, and the focus is now on investments in kids, in areas where we have seen benefits, and in trying to encourage more people to get into the labor market rather than receiving cash transfers.

**DIMITRI
PAPADIMITRIOU:**

But outside of the defense expenditures, are there any other expenditures which should be eliminated in favor of other kinds of social expenditures?

TIMOTHY SMEEDING: Yes, farm subsidies. We spend twice as much on farm subsidies as we spend on food stamps, and they are distributed exactly in the opposite ends of the distribution. Maybe we could use some of this to get an output measure for education in order to figure out how well kids are doing. We need some sort of a national standard by which we can judge how well the system works. Once we have got that, then at least we have got some target and can tell if we are getting better or worse and whether things are working or aren't. I think this is incredibly important and would use the farm subsidy money for it.

WILLIAM DICKENS: I will disagree with what Bob has introduced in the discussion as subsidies for low wages. Although I agree with just about every other policy recommendation that Bob has put out there, I think this one is a bad idea from the standpoint of mainstream economics, because if you subsidize low wages, you are not going to succeed in changing the relative return if that return is due to acquired skill. All you are going to do is increase the number of people who don't go out and get higher education and make the distortion worse. I tend to think that what determines wages is the ability of labor to extract rents from capital. If you subsidize low wages as opposed to subsidizing low-skill employment, you are going to increase the number of people employed in the low-wage, low-productivity industry, decrease the number of people employed, and have a negative shift. You can at least somewhat undo that by subsidizing low-skill as opposed to low-wage unemployment, but even that has the problem that I just talked about before.

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Why not subsidize high-wage employment? If you subsidize high-wage employment, then you shift people from low-productivity jobs to high-productivity jobs. The people who are left behind have lowered the supply of workers to those sorts of jobs and might increase the wages there. That seems to me to be the preferable policy.

Let me also put in two cheers for the V.A.T., which I stuck into the conversation a second ago. Yes, it is regressive if you look at it on the surface. However, a colleague of mine at Berkeley is fond of pointing out that if you look across countries that have had major tax revolts, they have been countries that have primarily funded their national expenditures out of income taxes. Countries that have primarily funded their expenditures out of V.A.T.'s have not had the tax revolts. Thus, in a sense, the V.A.T.'s are actually progressive. They can go along with persistent maintainable progressive social policies because V.A.T.'s are hidden and people don't get their paycheck and see the tax bite there.

One other thing which has never ceased to amaze me. We have just gone out in the last six months and we have taken on at least the fourth- if not the third-largest military power of the world and quickly made absolute waste of them with a loss of less than 200 American lives. And the media concludes from this that it is a big boost for the military. Undoubtedly, this is going to increase military spending. In what sense is this rational behavior?

ROBERT HAVEMAN: I welcome Bill's comments on the possibility of subsidizing either the demand side or the supply side of the labor market for disadvantaged workers because his perspective on this as a labor economist is certainly nonorthodox.

It was about a decade ago, in fact, when there was a lot of attention paid by what I would call, the mainstream labor economics wing of the profession to the thought that employment subsidization of one kind or another had high potential. Some of the benefits of it were benefits that I alluded to in my comments in addition to other benefits such as shifting the Phillips curve. The major objections to it that were then raised had to do with the traditional union-oriented objections, that said if you subsidize low-wage workers, you are going to displace union workers, and perhaps this is why you take such vehement exception to the proposals.

There were suggestions and research of a serious kind 10 or 15 years ago by people such as Tobin, Eisner, and others who thought through these things and didn't find them to be as wacky as you seem to. However, I think your point is right that if they are out there, they have potential; it is worth it to see if that kind of reform of the labor market has potential for those people trapped at the bottom of the capability distribution.

WILLIAM DICKENS: Just briefly, I don't think there is anything nonmainstream about human capital period which is the basis of my objection. It is one thing to talk about general wage subsidies as ways of creating aggregate employment, and that is something we could debate in America and could get us in trouble, as with Swedish active labor market policies and so on.

ROBERT HAVEMAN: Bill, look, you are looking at a particular policy proposal and you are finding one component of it that you are putting a negative sign in front of and saying, therefore, let's discard further thought about it because it tends to

provide a relevant disincentive for additional higher education and training expenditures. And I am saying that it is worthwhile lining up all of the benefits and cost accounts and seeing if the policy makes sense.

WILLIAM DICKENS: Fair enough. Most of the previous discussion about this issue in the active labor market literature, which you are pulling in on your side, was not a specifically low-wage employment subsidy but was a general employment subsidy. I am suggesting that if the cause of the change in the income distribution has been the sort of response to the supply side factors that I described, then you are not going to effect it by doing this. You are only going to exacerbate the underlying problem.

TIMOTHY SMEEDING: Now listen, you guys. We have one of these subsidies out there right now called the Earning Income Tax Credit. In this state, if employers hire low-wage workers and train them, then they can give out checks at the end of the week that include approximately a dollar an hour more in subsidy.

No one knows what effect this EITC is really having. No one knows how many employers are picking up on this and using it every week, so to speak. No one is pointing out to their employees or potential employees with children that, in fact, they can get an extra dollar an hour if they take it. We just don't have the data right now. No one knows exactly who is participating, and how eligible they are. All we know is that it will be about eight million dollars this year net effect, and by next year it will be about ten million dollars.

**DIMITRI
PAPADIMITRIOU:**

Before I turn the floor to the audience for questions, I want to put you all on the spot. Let's assume that Michael Boskin resigned today and you were to receive a call from the white house to accept the chairmanship of the Council of Economic Advisors. What would you advocate as the number-one policy?

TIMOTHY SMEEDING: Refundable child credit and universal Head Start. If George Bush believes that Head Start is so great, then they should make it an entitlement.

ROBERT AVERY: I agree with Tim on child care. I would move in the margin to increase various taxes, taxes on the elderly, taxes on social security, and I clearly would move to reduce expenditures in defense and other areas as well. Compared to the overwhelming nature of the revenue and expense side, most policies we are talking about here, in my view, would be of secondary concern.

ROBERT HAVEMAN: I would set up a task force to study the feasibility of a personal capital account for youths, perhaps, on the same order as Ed was talking about, and I would set up another one to look at ways of making work by less skilled disadvantaged workers more attractive, both to them and to potential employers.

EDWARD WOLFF: My number-one priority would be universal health insurance, but I would also pursue social security capital funds and cut defense spending and intelligence operations.

SHELDON DANZIGER: Well, earlier in this session I laid out a package that I thought would cost thirty or fifty billion dollars, but let me add something else. One of the things that stopped in the '80s, in addition to spending on the poor, was experimentation. I would like to experiment with some of these various kinds of wage rate subsidies so you could really tell how well they operate.

WILLIAM DICKENS: If I were Michael Boskin right now, I would try to find an excuse to get back to Stanford so that I don't get blamed for what is going to happen. As far as specific programs go, there is a long laundry list which just boggles the mind. Most of them have been mentioned here, national health insurance, various sorts of improvements to our family policies, and so on.

I am very concerned about the deficit. So that is why I think Michael Boskin is in a real tight spot and I don't know what he can do about the deficit, given a weak economy and the monetarists controlling the Federal Reserve who seem to be more concerned about the slightest hint of inflation than they are about the 7 or 8 percent unemployment.

With specific respect to the distributional issues that we have been discussing today and yesterday, it seems to me we should be doing something for education. If we are particularly worried about the low end, then maybe we should be concentrating on preparing people with less advantaged backgrounds better for college so that they can make that transition. We should also be doing something about inner-city education, doing something about children's preparation for education, going all the way back to things like family policy to make sure the kids have enough to eat and have reasonable access to programs like Head Start.

QUESTIONS AND REMARKS FROM THE FLOOR

THE FLOOR: I want to make a comment with respect to Head Start. I hear a lot of people talking about Head Start and the view of our panel here is that if we only put more money towards Head Start, it would be a wise investment. If you look at recent analyses, however, it turns out that there is a low take-up rate because Head Start is not a full-day program. So, you have to redesign Head Start in terms of providing child care around it, or expanding the time in order for it to be successful.

This brings me to my first point. A lot of the discussion we have just heard is about one policy here, one policy there, and they are all directed toward particular difficulties. There is really a need for a coordinated policy. You need to look at the whole constellation of problems and try to have a set of coordinated policies. Head Start and concern for working parents is a good example.

The second is that we have a changing demographic composition and that if you look particularly at children, the nature of today's children is changing. Part of the reason the poverty rate has gone up is children are living in single-parent families, and more of the children are not white. These are increasing trends. If you are going to be designing policy, it seems to me, you want to have a forward look and keep in mind the nature of those policies.

Now, my last point. A source of income that would have all sorts of benefits would be to tax beyond some minimum amount the component of fringe benefits that are private health insurance. This would get rid of this kind of unlimited nature that might keep the percentage increasing at the rapid rate that it is now. It also has the consequence where high-income people get a larger benefit of the tax subsidy than those in the lower incomes.

THE FLOOR: I would like to make a very politically incorrect proposal here, in addition to a couple other things.

First, the idea of welfare for able-bodied adults is something that I think should be vastly expanded, not merely kept the same or whittled away at for a couple of reasons. It is hypocritical for a society to create unemployment for people who can work the least, who have the least ability to work, and then punish them for not finding jobs. It is sort of like whipping a horse to go up a down escalator.

Second, a lot of welfare payments are based on the concept of able-bodied versus disabled, and when you get into that sort of moralizing, I think it is a giant leap backwards into the 19th century where you set yourself up as a judge over an inferior class of people, allowing those who you deem worthy enough for your largess to receive it.

Third, considering the paltry amount of welfare anyway, I think it is, again, demeaning to impute that somebody is going to accept \$4,000 a year, or \$3,000 a year, because they don't like to work rather than looking at the reasons why they are not working.

Fourth, this gets into the integrating of the things. Welfare alone is a misguided policy. It is our failings to provide not just a full employment economy but the rehabilitation, the job supports, the education, the day care, the medical care — everything that goes around working — that would reduce the need for the demand for welfare.

Fifth, it is very expensive to take up the consequences when you cut people off. You throw people in the gutter. It is very crippling and leads into a more general problem for why we have a widening income distribution bifurcation. We think it is the problem of dichotomizing the rich who have earned their way through their own efforts and who deserve it and will be given all of the positive incentives and the people who don't need to be punished and have the support taken out from them.

THE FLOOR: I am a veteran of World War II and was also an employer, but two things came out of World War II that have been overlooked — not only the Marshall Plan, but that great social experiment known as the GI Bill of Rights. What did it do? It enabled hundreds of thousands of poor boys to go to college. It enabled hundreds of thousands of young GI's to buy homes. It enabled hundreds of thousands of GI's to get subsidies as a premise in their employment. Now, all of the things we have discussed here can be found in the GI Bill of Rights, and it worked very, very successfully. However, it has been overlooked by economists over all these years. I participated in these various programs in completing my education and also later on as an employer in taking on apprentices and training them and getting part of their salaries subsidized.

WILLIAM DICKENS: Given the current composition of the U.S. military and political feasibility, it seems to me that something along the lines of a GI Bill of Rights would be a very progressive move. It defeats the selectivity of the current method of getting people into the military. It is a good way of targeting and would work even better now.

TIMOTHY SMEEDING: Well, if you extended it to the rest of the population, it would be right where Wolff and Haveman are. That is what this universal capital account is really and what it is providing.

THE FLOOR: It worked, and there was no abuse; if there were abuses, they were very, very few.

EDWARD WOLFF: That is really a good point, and I don't think anyone has studied it.

THE FLOOR: What are the assumptions about people's motivation and the assumptions about how the economy works behind this consensus that we shouldn't give the able-bodied a higher welfare?

SHELDON DANZIGER: One of the ways we got a consensus on helping the working poor is because we don't have to discuss whether or not they are deserving or not. This whole notion of making work pay is an area on which there is a consensus. Higher benefits for nonworkers are much more controversial.

Yet the money is not there, which clouds the issues. Taxing fringe benefits makes great sense, but if Rostenkowski is not going to move on that because the union is there, in part, then talk about something else. It is more a political thing.

THE FLOOR: It seems to me the general strategy to lower the cost of being poor is to reduce the cost of living for the poor. We haven't talked about the housing problem, the increases in housing costs of housing that young families fear greatly. A policy to increase the amount of low-income housing would be very effective for that particular segment of the population without distorting the incentives to work. As a general strategy that is extended also to food prices, health care, etc., you could try to design policies that make it cheaper to live in America.

DIMITRI PAPADIMITRIOU: Let me touch on an issue which refers to the multiple number of indices that we have seen used in the presentations of this conference's papers. Is it possible to devise a single and objective index of "well-being" or "misery" which would be relatively easy to compute and able to withstand the arbitrariness of individual value judgments and thus be widely accepted? Nowadays, we have evidence of families who are above the official poverty level and yet aren't able to afford adequate housing and health care.

BARBARA WOLFE: That is what the Lyden School came up with. What they essentially do is conduct a survey and ask people who are of different income levels what they think they would need to live at a decent standard of living. They do this for people of different ages and different characteristics to try to get a type of index that would incorporate particular needs for health care or housing. Presumably, they are specific to a type or so.

THE FLOOR: One of the problems with that is that it makes the response related to particular people's income, and people are very, very sensitive to questioning. For example, for just groups at \$350,000 homes, the answer to the question of how much you need to get by will probably be in the neighborhood of \$5,000 a month. I would clearly be worried a lot about responses like that.

DIMITRI PAPADIMITRIOU: I think I want to bring the policy forum and this conference to a close. I want to take this opportunity to thank the organizer of this project, Edward Wolff, and the members of the research team for their thoughtful and provocative presentations. I do also want to say that even though we at The Jerome Levy Economics Institute will be focusing more on analyzing the problems of unemployment and employment growth and decline in both the government and private sector, the quality and creation of jobs and the structure of supply and demand of labor markets, we see all these issues relating to solutions that will combat earnings inequality and poverty.

So, you will be hearing from us, those of you who are still interested in us, as we are interested in you. Thank you very much.

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